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MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE SECRETARY OF ENERGY
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
UNITED STATES TRADE REPRESENTATIVE
DIRECTOR OF CENTRAL INTELLIGENCE

SUBJECT: Senior Interagency Group on International Economic Policy (SIG-IEP)

Attached are papers for the SIG-IEP meeting which will be held on Friday, October 15, at 3:00 PM in the Roosevelt Room:

Agenda Item 1 U.S. Agricultural Export Policies; and

Agenda Item 2 Grain-For-Oil Barter.

David E. Pickford
Executive Secretary

Attachments

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Discussion Paper on Agricultural Trade

Current Agricultural Situation

Large crops, low farm income and subsidized EC exports have led to political pressure in the United States for U.S. export subsidies.

Record world-wide crops in 1981/2 and 1982/3 have driven down farm prices. Net farm income in the United States is down sharply in the last three years. U.S. cereal prices have declined (September 1981-September 1982) by 8 percent for wheat, 32 percent for rice and 15 percent for corn. World grain stocks at the end of FY83 are expected to be at their highest level in 20 years with more than half of these carried by the United States. To curb the supply of grain, the USG is undertaking a major program to reduce acreage in 1983. Despite efforts to hold the line on dairy support prices, CCC dairy stocks are expected to increase substantially in FY83, costing the Government $2 billion for the second consecutive year.

The European Community's Common Agricultural Policy (CAP) is aggravating the problems of the American farmer. The high support prices of the CAP have stimulated surplus production while high consumer prices have discouraged demand. The EC has used export subsidies to move excess production into world markets rather than hold it in stocks. Although U.S. prices are down, EC producer prices for major crops are up 10 percent or more over last year. The EC has recently become a net exporter of cereals, beef, poultry and sugar.

U.S.-EC Agricultural Issues

GATT rules on agricultural subsidies are insufficient and weak. The GATT prohibits the use of subsidies to gain more than an equitable share of the agricultural market or to undercut substantially the prices of other exporters. The GATT does not address the income loss to U.S. farmers from low prices caused by excess production induced by subsidies. Therefore, the USG should seek better discipline over export subsidies and excess production in the agricultural sector.

Objectives

(1) Increased farm income/exports.

(2) Short-term resolution of key U.S.-EC trade disputes.

(3) Long-term international agricultural adjustment, by bringing the domestic prices of all major producers in line with world prices and allowing comparative advantage to work.

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Policy Questions

Given our current agricultural disputes with the EC, the SIG should consider the foreign policy implications of --

(1) alternative uses of the $175-190 million authorized by the Omnibus Reconciliation Act of 1982 to promote exports and

(2) use of the $500 million in CCC direct loans contained in the House and Senate agricultural appropriations.

Some of the questions policy makers need to address include the following:

(1) Should the USG subsidize U.S. agricultural exports?

(a) Direct export subsidies?
(b) Interest rate reductions (buy down arrangements or blended interest rates, possibly limited to strategic countries like Mexico)?
(c) Non-subsidy alternatives (direct export credits at non-subsidized rates and expansion of guarantee coverage of CCC loans)?

(2) Should we target these subsidies at the EC or use them to gain market shares in non-EC markets? Should we use them against the EC --

(a) before the GATT Ministerial?
(b) after the Ministerial, if unsuccessful?

(3) Should we subsidize only a few products or all agricultural exports? What are the implications for our international obligations of subsidizing dairy exports when we have not been a traditional exporter?

(4) Should we seek a negotiated solution?

(a) Multilateral solution (tied to the GATT Ministerial)?
(b) Bilateral solution?
(c) Forgo negotiations and concentrate on gaining market share by using U.S. subsidies?

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Swapping U.S. Grain for Oil for the SPR

The United States Government holds approximately $900 million worth of grain (300 million bushels) which it could offer to barter for oil for the SPR. While technically feasible, such barters are unlikely to be economically advantageous to the U.S. because:

-- For 1983 nearly all of the oil which can be acquired for the SPR under approved Presidential budget levels has already been acquired.

-- Increased exports from oil exporting countries under a barter would relieve pressures upon them to cut prices and thus could strengthen, rather than weaken, oil prices.

-- Unless sales of U.S. grain in a barter arrangement were incremental and did not decrease world prices, FY 1983 budget outlays and the deficit would rise.

While it appears that the barter of agricultural products for oil might be technically feasible -- stocks of agricultural products are owned by the government, basic legal authority exists for barter transactions, and surplus oil production capacity exists abroad -- it is difficult to foresee circumstances under which it would be advantageous to the United States.

Potential partners in an oil-grain swap appear to be limited to Nigeria and Indonesia. Both produce at less than their sustainable capacity (with Nigeria at 200,000 b/d under its OPEC ceiling), are in financial difficulties, produce the type of oil needed for the SPR, and import substantial quantities of food. However, DOE's current acquisition plans and existing contracts leave little room for additional purchases in FY 83. Moreover, additional exports by Nigeria and/or Indonesia in the form of barter for the SPR would reduce pressure on them to cut their prices. Thus, a swap could actually be counter-productive.

As far as the agricultural side of the swap is concerned, U.S. legislative requirements strictly limit the possibility of such trades. USG-owned grain must be sold at substantially above world market levels. Even if this legislative requirement were eliminated, barter of government-owned grains would be likely to depress prices both internationally and domestically, increasing price-support program expenses. Estimates made by Department of Agriculture and OMB staffs suggest that liquidation of CCC owned stocks of grain would increase the federal budget deficit by $700-1,300 million in FY 1983 through increased CCC loans and storage payments resulting from the displacement of commercial grain exports. Barter involving dairy products would not have these disadvantages. They could be sold at or below world prices, as far as U.S. law in concerned, and the international

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market is already heavily subsidized and in over supply. However, the U.S. could run afoul of the GATT where it is seeking to strengthen GATT rules on agricultural export subsidies and would itself become a major offender.

Thus, it is not apparent what advantages barter would offer in comparison with conventional market sales and purchases. Barter is generally unattractive from the trade policy standpoint because of its inherent inefficiency and rigidity. Moreover, it would set a harmful precedent for countries who pressure the United States regularly to accept their exports in exchange for their purchases of our exports. The very features that would make it attractive to the U.S. -- the promise of additional sales of grain at market prices and/or an implicit discount price for the oil -- would probably make it unattractive to the prospective trading partner.

The possibility always exists of private sector counter-trade agreements involving the export of U.S. grain in exchange for commodities which private firms expect to sell at a profit. U.S. policy toward such private barter transactions should be the same as for other private sector activities -- including the "good offices" of U.S. embassies.

Attachment

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Swapping U.S. Grain for Oil for the SPR: The Analysis

Oil Market Conditions - Oil price increases have spurred production outside OPEC. Since 1973, non-OPEC crude production has increased by nearly 5 mmb/d, or 32%, to nearly 20 mmb/d. Moreover, these producers are generally charging what the market will bear, and OPEC -- with its cartel prices -- has increasingly become the marginal supplier to the market. OPEC's share of the Free World crude market has declined from about two-thirds in 1978 to less than half.

OPEC nations are currently the only producers with significant excess capacity. Of these, some -- the Arabian Peninsula countries -- most likely have sufficient financial strength to resist current market pressures; others - Venezuela, Libya, Iran -- are basically ignoring their OPEC ceilings and/or discounting prices; yet others -- Libya, Iran -- for foreign policy reasons are not logical candidates for an oil for grain swap. This leaves Nigeria and Indonesia as the most likely candidates. Both are experiencing financial difficulties and import substantial quantities of grain. Nigeria imported 1.3 million tons of wheat and corn and 600,000 tons of rice in 1981, two-thirds from the United States. Indonesia imported 1.4 million tons of grain in 1981, half from the United States.

Among non-OPEC countries, Mexico is frequently mentioned as a possible candidate for an oil for grain swap, even though it is currently producing near or at capacity. Mexico's budget for 1983 assumes exports averaging 1.7 mmb/d -- close to current exports. Moreover, Mexico is such a major importer of U.S. grains -- roughly 3 million tons in 1981 -- that it would be particularly difficult to assure that a swap with Mexico generated additional U.S. grain exports.

In theory, the swap of Nigerian, Indonesian, or Mexican oil for grain could increase pressure on oil prices by displacing cash sales of oil by other producers. However, the potential exporters are also those most desperate to sell. A swap -- by relieving this overhang -- would reduce pressures upon them to cut their prices and thus could actually strengthen the market. The situation is further complicated in the case of Mexico by existing deals which will lead to the delivery of 40 million barrels for the SPR over the next year at Mexico's official selling prices. An additional deal might relieve pressure upon Mexico to keep its prices competitive or -- in any event -- be criticized as having this potential.

Finally, recent SPR purchases -- including the Mexican deal -- leave little or no room for additional purchases during FY 83, unless additional funds are appropriated for this purpose (or a swap could be arranged outside the budget, which is not possible). While the current statutory requirement is for purchase of

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Estimated Free World Spare Capacity
(million b/d)

Country	Aug., 1982 Production	Estimated Capacity	Capacity Available under the OPEC Ceiling	Total Excess Capacity	Excess of 1/ SPR Quality
Free World	26.2	37.0	17.5	10.8	09.4
North America	4.1	4.5	NA	0.4	0.2
Canada	1.2	1.4	NA	0.2	0.2
Mexico 1982	2.9	3.1	NA	0.2	0
1983	3.2e	3.4e	NA	0.2	0
Europe (North Sea)	2.7	2.7	NA	0	0
Norway 1982	0.6	0.6	NA	0	0
1983	0.7e	0.7e	NA	0	0
UK 1982	2.1	2.1	NA	0	0
1983	2.2e	2.2e	NA	0	0
Middle East	11.2	18.8	11.6	7.6	6.9
Iran	2.0	3.5	1.2	1.5	1.4
Iraq	0.8	0.9	1.2	0.1	0.1
Kuwait	0.8	1.5	.6	0.7	0.7
Neutral Zone	0.2	0.6	.3	0.4	0.2
Oman	0.3	0.3	NA	0	0
Qatar	0.3	0.6	.3	0.3	0.3
Saudi Arabia	5.6	10.0	7.0	4.4	4.0
UAE	1.2	1.4	1.0	0.2	0.2
Latin America	2.3	2.9	1.7	0.6	0.1
Ecuador	0.2	0.2	.2	0	0
Trinidad	0.2	0.3e	NA	0.1	0
Venezuela	1.9	2.4	1.5	0.5	0.1
Africa	4.1	6.0	2.9	1.9	1.9
Algeria	0.7	0.8	.7	0.1	0.1
Egypt	0.6	0.7	NA	0.1	0.1
Gabon	0.2	0.2	.1	0	0
Libya	1.5	2.1	.7	0.6	0.6
Nigeria	1.1	2.2	1.3	1.1	1.1
Far East	1.8	2.1	1.3	0.3	0.3
Brunei	0.2	0.2	NA	0	0
Indonesia	1.3	1.6	1.3	0.3	0.3
Malaysia	0.3	0.3	NA	0	0

e - Estimate
NA - Not Applicable
1/ - Crude Oil of API Specific gravity less than 30° is not usually purchased for the SPR.

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Source: Stra

300,000 barrels per day in FY 1983, subject to availabilty of funds, DOE's current acquisition plan and previously contracted deliveries leave room for only small additional purchases of high quality light crude oil in FY 1983. (DOE has not provided precise figures). If, however, a barter did lead to increased purchases for the SPR, this would be likely to strengthen the market as a result of the increased demand for oil. Moreover, any purchases above 220,000 b/d would require the rent of temporary high cost ($2.00-$3.00 per barrel per year) storage facilities, largely offsetting any saving in costs of storing excess grain.

Agricultural Commodity Supplies - The U.S. Government currently owns substantial quantities of agricultural commodities, much of which is subject to sales price constraints where the generally allowable minimum price is significantly above world market levels. These supplies are expected to increase significantly over the next year, increasing in valuation from $4.1 billion on September 10, 1982 to about $6.3 billion by September, 1983, mostly due to record-breaking grain production throughout most of the world and subsidy programs. Unless directly tied to market expansion (incremental demand), release of these commodities on the market would effectively increase supplies, depress world prices of the commodities, increase U.S. Government price support costs on unsold private inventories, and reduce U.S. farm income.

Uncommitted Commodity Credit Corporation Grain and Dairy Product Inventories

	September 10, 1982		Projected September, 1983	
Commodity	Release Price	Value 1/	Release Price	Value 1/
Grains				
Corn 2/	$ 3.25	$811.1	$ 3.25	$1,537.3
Wheat 2/	4.65	193.8	4.65	1,048.6
Grain Sorghum 2/	3.09	39.8	3.10	187.6
Oats	1.67	.9	1.65	--
Barley 2/	2.65	2.3	2.65	23.3
Rice	8.01	124.2	8.14	32.6
Subtotal		$1172.1		$2,829.4
Dairy Products				
Butter		$579.0		$739.5
Cheese		1113.1		1324.6
Non-fat dried milk		1205.1		1456.1
Subtotal		$2,897.1		$3,520.2
TOTAL		$4,069.2		$6,349.6

1/ Valued at 110 percent of trigger release price where stored.
2/ Minimum sales price must be equivalent to at least 110 percent of trigger release prices unless the Secretary of Agriculture determines that disposal to prevent waste is in the public interest.

Estimates made by Department of Agriculture and OMB staffs suggest that liquidation of CCC-owned stocks of corn and wheat by bartering would increase the federal budget deficit in FY 1983 by approximately $660 million to $1250 million. These estimates reflect the expectation that bartering these commodities will reduce the world price for the commodities. The liquidation of CCC stocks is forecast to increase U.S. exports slightly (by 10 million bushels of wheat and 25 million bushels of corn in the case of total liquidation), but the main effect is to displace commercial grain exports thereby increasing the volumes of these grains in the farmer-owned reserve, in other farm stocks under regular CCC loans, and in CCC take-overs (new acquisitions). The net result would be an increase in 9-month CCC loans and storage payments for the farmer-owned reserve FY 83 of $743 million (if only uncommitted stocks are liquidated) and $1367 million (if all stocks are liquidated). These costs would be partially offset by a reduction in CCC storage costs ($57 million in the case of uncommitted stock liquidation, $101 million if all CCC corn and wheat stocks are liquidated).

Moreover, under current law CCC cannot liquidate any corn or wheat stocks for less than 110% of the trigger release price -- which is substantially above current market price. If it were legal for DOE to reimburse the CCC at 110% of release price (actually, DOE cannot legally pay more than the fair market value value, DOE outlays to reimburse the CCC would be $1007 million, in the case of uncommitted stocks, and $1919 million in the case of total stock liquidation. For this, DOE would receive 17.2 MB and 32.8 MB of oil, respectively, at a cost of $58.60 per barrel. At the estimated market value in FY 83 of $37.15, DOE would have to pay a subsidy of about $21.45 per barrel. On the other hand, if -- as seems very likely -- CCC has to discount the value of the grain by, say, 20% to induce oil exporters to accept grain instead of hard currency, then DOE would receive less oil and the subsidy would be greater. In this case, the cost to DOE would be $73.20 per barrel, or a subsidy of $36.05 per barrel.

In addition to these effects on the budget, the price depressing effects of bartering CCC stocks would affect prices realized on commercial sales and significantly reduce farm income. The farm value of wheat and corn production would decline by approximately $900 million to $1.3 billion in FY 83, depending on whether just uncommitted or total CCC corn and wheat stocks are liquidated.

Due to the absence of arbitrary floor price restrictions, transactions in which U.S. Government-owned dairy products -- butter, cheese, or non-fat dry milk -- are exchanged for foreign-owned oil are more likely to yield favorable economics than deals involving government-owned grain.

A barter transaction for dairy products would not be likely to affect prices or production due to the present heavily subsidized, over supply situation and small world market. There would be a reduction in CCC inventories by the amount of the agreement and the CCC would be reimbursed by DOE for the value of dairy products exported. In addition to a reduction in CCC inventory there would be a net saving to the Treasury of outlays for storage and handling: butter at $0.0384 per pound per year, cheese at $0.0359 per pound per year and non-fat dry milk at $0.0131 per pound per year. Complete liquidation of current CCC stocks of these products at world market prices, a highly unlikely event, would yield 36.7 million barrels of oil and save $58.6 million in CCC storage costs, in addition to forestalling public cash outlays by the Department of Energy and resultant interest expense.

A counter trade agreement to sell grains purchased on the open market would have no immediate impact on CCC inventories. There would be a price impact as purchases to meet the contract are made by the private trade. It is estimated that a 2 million metric ton sale of wheat would increase its price by 1.5-2.0 percent. At the current price of $3.32, this would increase wheat prices by six cents per bushel. The same size sale of corn would result in an increase of 5.0 percent. At the present corn price of $2.30 the sale would be expected to raise price by 10 cents per bushel.

Thus, U.S. legislation requirements and marketing conditions strictly limit the possibility that an oil for grain swap could be advantageous to the United States. The economies could be more attractive for dairy products, but the United States would have to compete with other producers that are subsidizing their exports. Moreover, the U.S. could run afoul of the GATT if it succeeded in negotiating such a swap.

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